pbbIX
Office Property Market Germany
2021 | Q2

DEUTSCHE
PFANDBRIEFBANK

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Overview

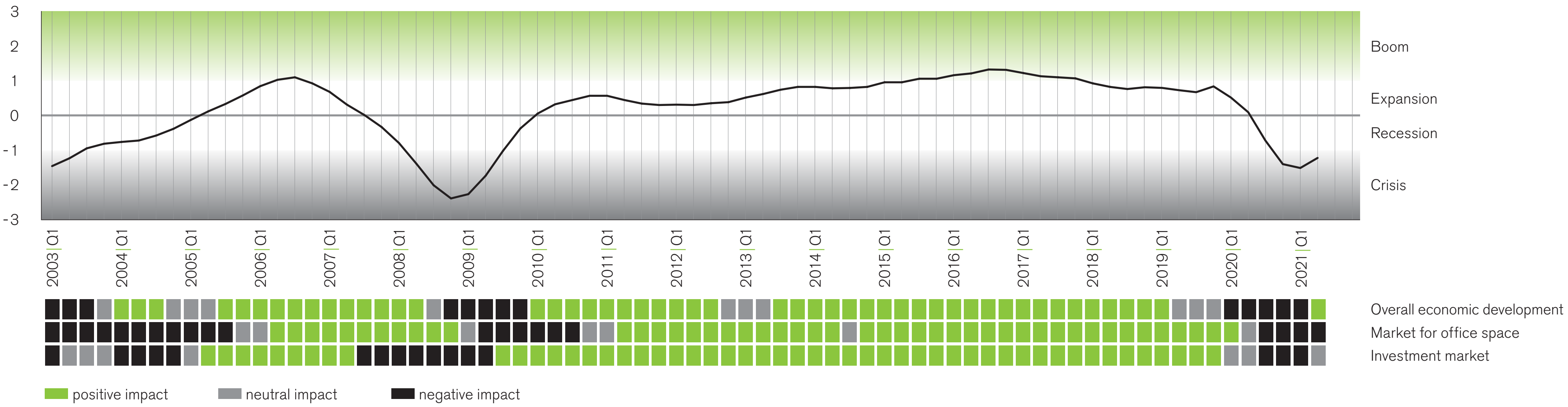
Whilst the pbbIX real estate index remained in negative territory during the second quarter of 2021, it increased by 0.29 index points to -1.23 index points, meaning that the **downturn is slowing**. This development was driven mainly by the improved macroeconomic development in Germany and a recovering investment market.

The German economy put in an excellent performance during the second quarter. **Private consumption rose significantly**, supported by stable labour market trends, and against the backdrop of catch-up effects and reduced lockdown measures. Had it not been for supply chain constraints as well as a general lack of primary products and materials, macro economic growth in Germany would have been even stronger.

Demand for office properties brightened significantly, with just under €6 billion spent on office properties across the big 7 markets in Germany – indicating that the **office investment market is slowly but surely shaking off the negative effects of the pandemic**. Initial yields responded accordingly, trending downwards for first-class properties in the second quarter. Demand for rental space on the other hand was low when compared to the pre-crisis levels.

The pandemic **holds fewer terrors**, but remains a threat. Virus mutations and rising infection rates constitute significant uncertainties; furthermore, the easing of lockdown measures could be reversed. Nevertheless, there is more evidence that the economy – and with it the office property market – will continue on its path towards recovery.

pbbIX BIG 7 | Index



Overall economic outlook

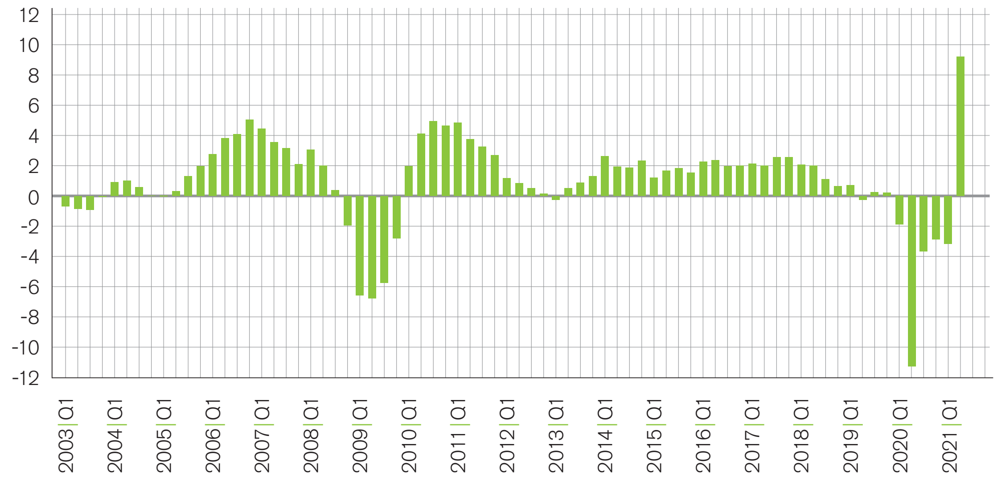
The economic situation in Germany improved significantly in the second quarter of 2021. According to first estimates of the German Federal Statistical Office, real gross domestic product showed an increase of 1.5 % compared to the previous period, offsetting most of the slump seen during the winter quarter. Whilst the year-on-year real GDP increase amounted to 9.2 %, economic output remained materially below pre-crisis levels.

Public expenditure and **private consumption** were the main drivers of economic growth. Eased lockdown measures and pent-up purchasing powerled to strong catch-up effects, materially increasing private household expenses for goods and services.

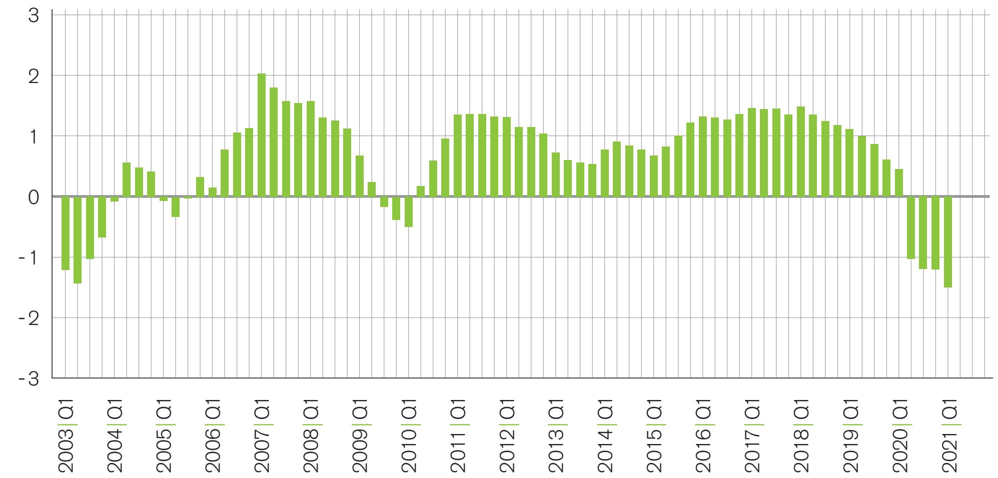
Barring the lack of materials and deliveries, the growth rate would have been even stronger. Following the most recent economic survey conducted by the ifo Institute, nearly two thirds of industrial enterprises complain that **ongoing supply constraints for raw materials and primary products** are limiting their production capacities. The construction industry is also increasingly fighting scarcity of materials.

In combination with rising coronavirus infection cases, these developments are somewhat dampening the economy's optimism. Companies are evaluating their current business situation more positively again; however, they are more sceptical when it comes to forecasts for the upcoming months. Nevertheless, the **recovery trend** is intact. Unless infection cases rise dramatically – and restrictive lockdown measures are re-imposed – economic output will continue on its path towards recovery.

Real gross domestic product | year-on-year change in %



Working population | year-on-year change in %



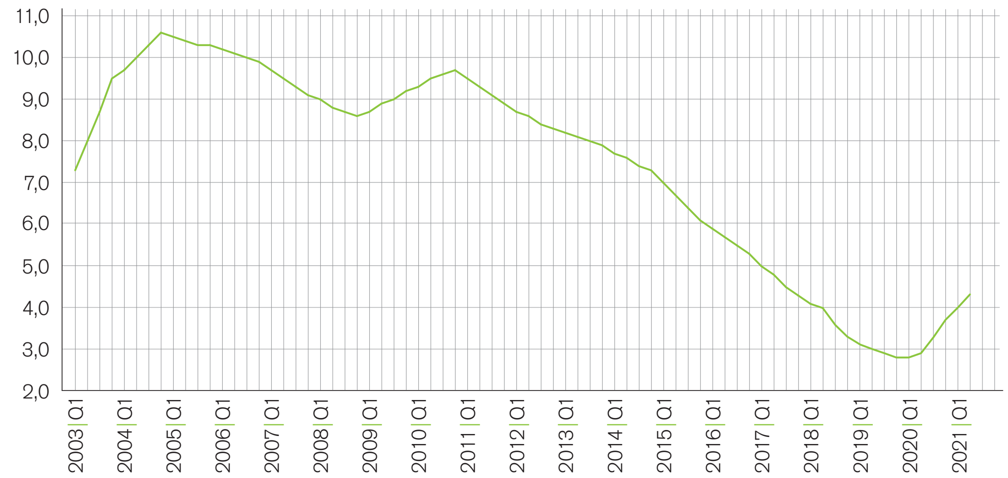
Market for office space

Demand for space is increasingly stabilising following the improved macro-economic development and related expectations. Approximately 600,000 sqm of office space was newly let on the big 7 markets during the second quarter, falling behind the result seen in the previous quarter, but exceeding the previous year's figure. The coronavirus pandemic has therefore definitively reduced letting performance; it is now around 30 % below the high levels of demand seen between 2015 and 2019.

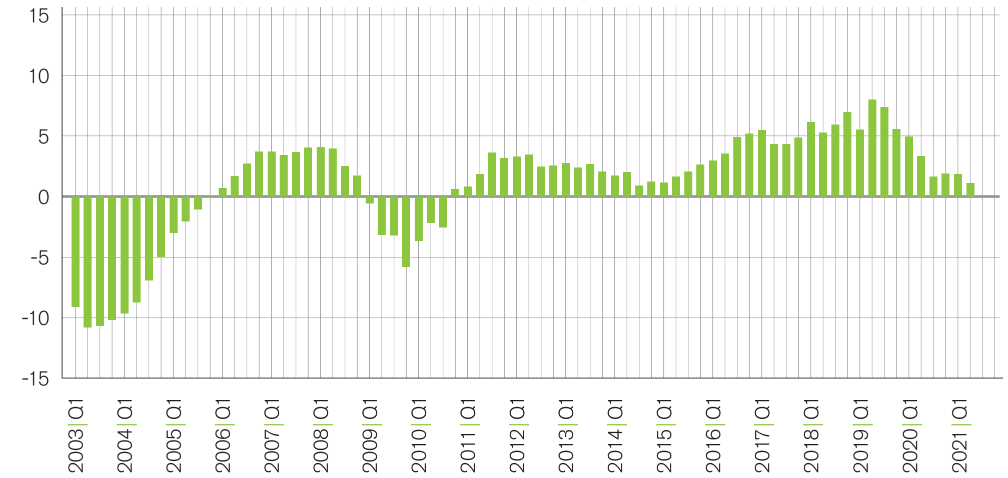
The consequences of the pandemic were also visible in vacancy rates: following the trends of the previous quarters, **office space was again being freed up**. At the mid-year mark, around 4.3 % of office space was vacant, with Frankfurt and Dusseldorf showing comparatively high vacancy rates. Vacancies remained within the fluctuation reserve elsewhere.

Nominal rents for newly-let space have barely reacted to the lower demand for space and higher vacancy levels. On average, top rents remained virtually unchanged compared to the previous quarter in all seven cities. The same applied to nominal average rents. However, the changed market situation impacted actual rent payments. Major real estate brokers are expressly noting that new business was accompanied by more tenant incentives, such as longer rent-free periods, increasingly **reducing effective rental income**. However, these higher temporary rental shortfalls are unlikely to have a game-changing impact on market values and prices. Longer-term prospects are decisive.

Office space vacancies (BIG 7) | in % of the portfolio



Top rents (BIG 7) | year-on-year change in %



Investment market

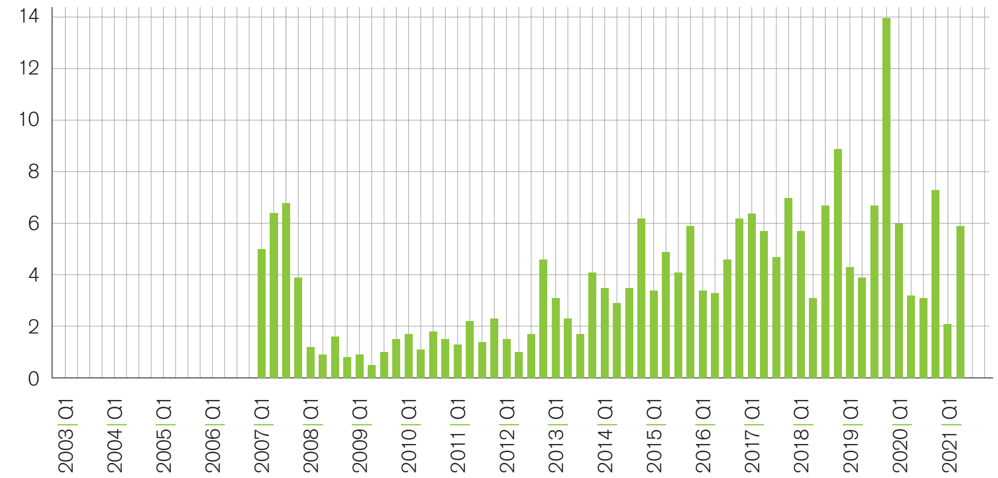
Inflows on the office investment market **strongly increased in the second quarter**. On the big 7 markets, office properties worth almost €6 billion changed hands. About 55 % of inflows came from abroad. According to Real Capital Analytics, Munich and Berlin were the preferred investment locations, together accounting for around 70 % of turnover.

As quarterly inflows are subject to strong fluctuations, it is too early to derive a full market recovery from the recent rebound. But combined with the high transaction volume in the fourth quarter of 2020, it is evident that **demand for office properties is picking up again**. The very weak beginning of the year was easily offset – and in sum, the results achieved in the first six months came in just below the pre-pandemic levels of the first half of 2018 and 2019, respectively.

The development of initial yields and prices also reflected the gradual recovery of the office investment. Despite the potential uncertainty on the rental market – as reflected by the subdued demand for space and rising vacancies – **initial yields are trending downwards again**. As opposed to the two preceding quarters, initial yields decreased somewhat in the second quarter. The gap between the yield and long-term interest rates on the capital markets narrowed further, with the latter increasing slightly.

Net initial yield (BIG 7) | in %

Investment volume (BIG 7) | in € billion

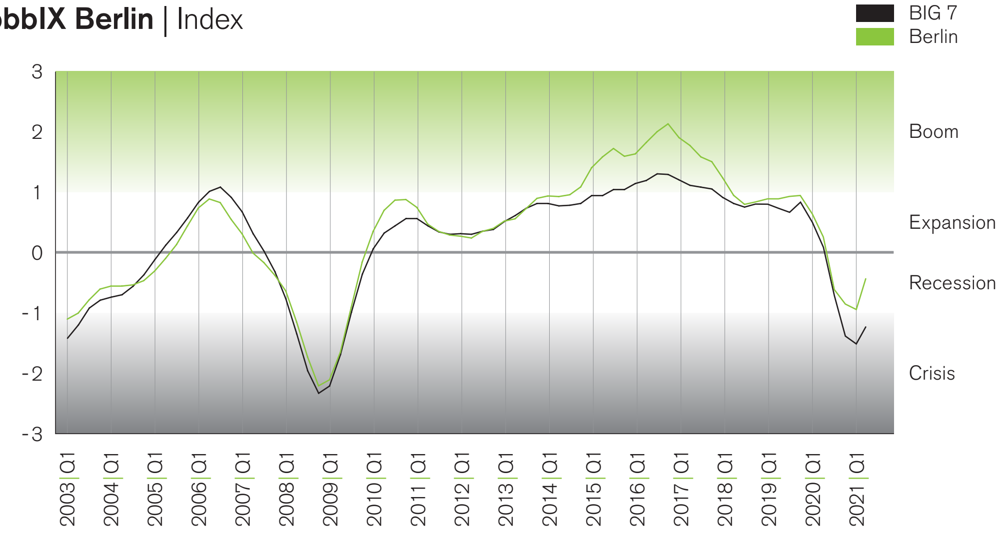


BIG 7

BERLIN

Following the comparatively high take-up in the first quarter, the second quarter turned out slightly weaker in Berlin. All in all, 365,000 sqm of office space was taken up during the first half-year, therefore exceeding the previous year's turnover by 10 %. The vacancy rate continued on a slight upwards trend and ended the second quarter at 3.9 %. Top rents remained unchanged, between €38 and €40 per sqm at the half-year mark. Inflows on the Berlin investment market improved significantly in the second quarter. The acquisition volume for office properties amounted to €1.7 billion, of which nearly €1 billion was invested from abroad. Following a long sideways movement, initial yields declined, ending the quarter at 2.5 %.

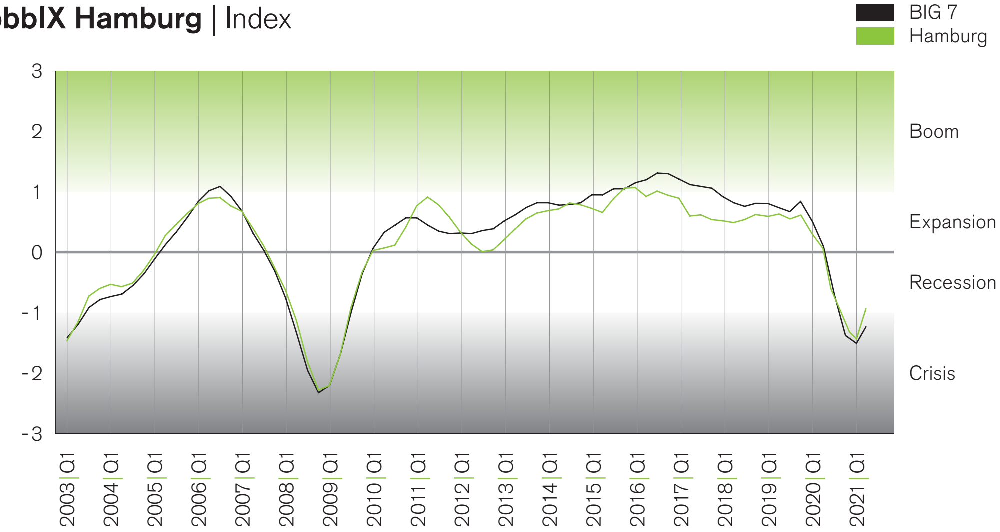
pbbIX Berlin | Index



HAMBURG

At just under 100,000 sqm, the letting performance in Hamburg remained well below the first-quarter result of 137,000 sqm. The previous year's turnover was exceeded by 40 % in the first half of the year. The still very low vacancy rate of 3.1 % only edged up slowly, whilst rents stagnated. The investment market showed a very subdued development during the second quarter, with an investment volume of approximately €115 million. Overall, the investment volume in the first half of the year amounted to only €600 million and thus was materially lower than in the corresponding periods in previous years. Since the yields for first-class properties in prime locations weakened slightly quarter-on-quarter, the lack of first-class properties was probably the reason for the weak investment result.

pbbIX Hamburg | Index

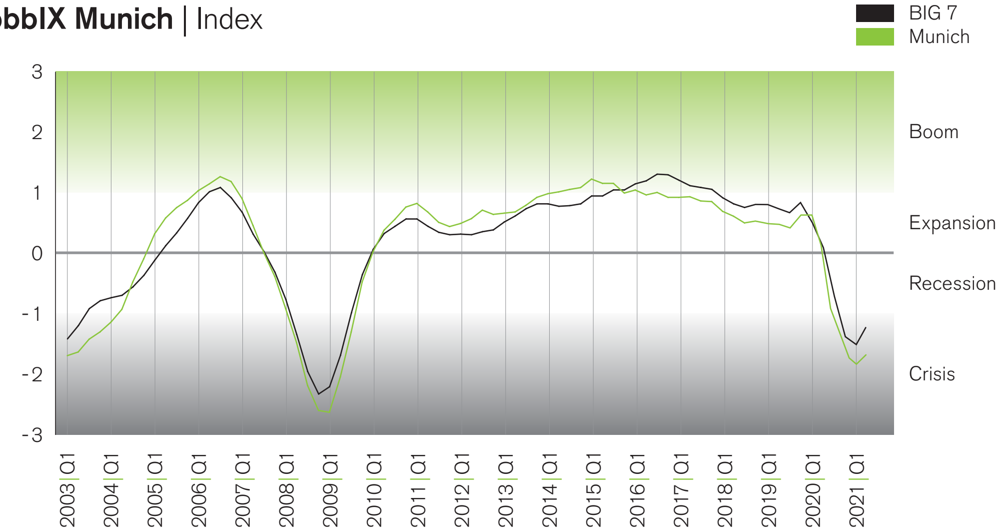


BIG 7

MUNICH

Due to a lack of large-scale lettings, the letting performance continued its very weak development during the second quarter. The statistics of major real estate brokers indicate a volume of just under 130,000 sqm, after around 105,000 sqm for the winter quarter. In sum, the previous year's turnover was undercut by approximately 30 %, which was one reason for another increase in vacancies, to roughly 4.2 % of office space, and thus 1.5 percentage points more than at the end of June 2020. Nominal top and average rents remained unchanged. Due partly to various large transactions, the transaction volume on the office investment market was very high in the second quarter (€2.5 billion), in fact, it was the second-best result on record. Net initial yields for first-class properties remained unchanged at around 2.7 %.

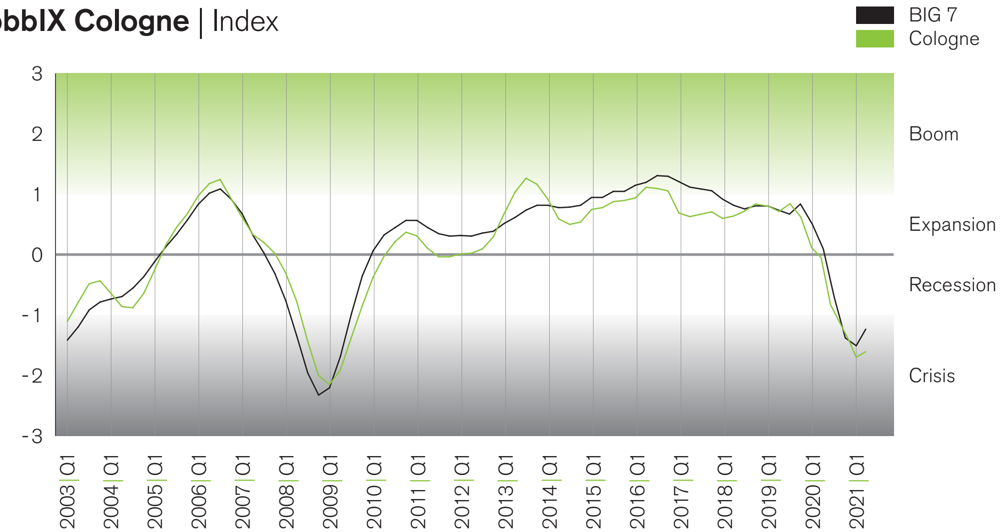
pbbIX Munich | Index



COLOGNE

The very high letting performance of the first quarter was not fully repeated during the second quarter. However, a figure of around 60,000 sqm is solid and – when added to the nearly 90,000 sqm from the first quarter – yields a convincing first half-year result with a 50 % higher turnover compared to the previous year. Nevertheless, the vacancy rate increased slightly to approximately 2.5% for prime locations and to around 3.5% for all locations. Nominal rents for newly-let space remained at a high level, with top rents still amounting to €26 per sqm. The investment volume for office properties amounted to just under €360 million in the second quarter. The last time turnover was higher was in the fourth quarter of 2019. Net initial yields for first-class properties were down by 10 basis points quarter-on-quarter, at 2.9 % as at end of June 2021.

pbbIX Cologne | Index

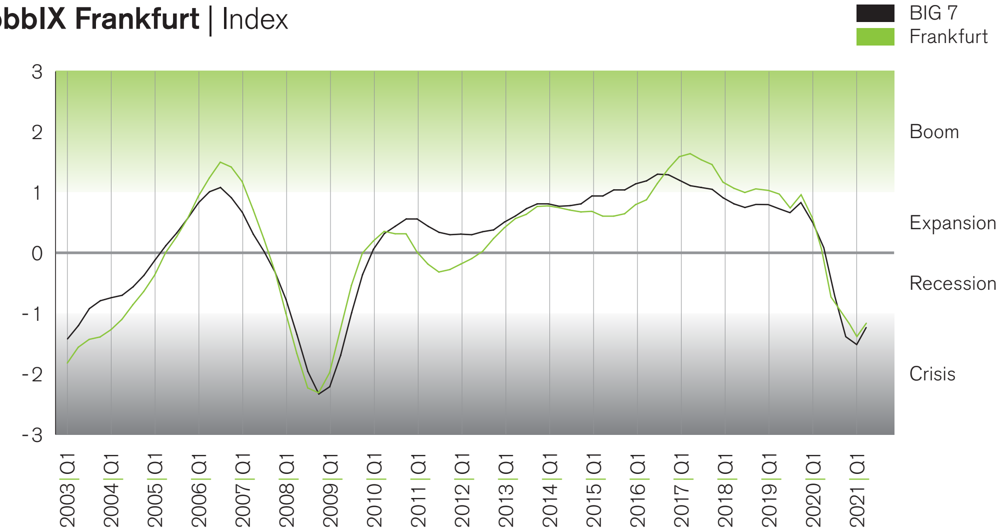


BIG 7

FRANKFURT

As in the previous quarter, only 83,000 sqm were let in the second quarter, yielding a letting performance of approximately 166,000 sqm for the first half of the year. Hence, the previous year's figure was exceeded by 50%, whilst in a medium-term comparison the result was below average. Despite significantly lower new construction activity, the vacancy rate rose to 6.6% in the second quarter. Nominal top and average rents for newly-let space remained at a high level. Compared to the very weak first quarter, inflows increased significantly in the second quarter, to €820 million (Q1: €460 million); compared to previous years, however, the investment volume in the first six months of 2021 was very low. Nevertheless, net initial yields for first-class office properties remained unchanged at 2.8%.

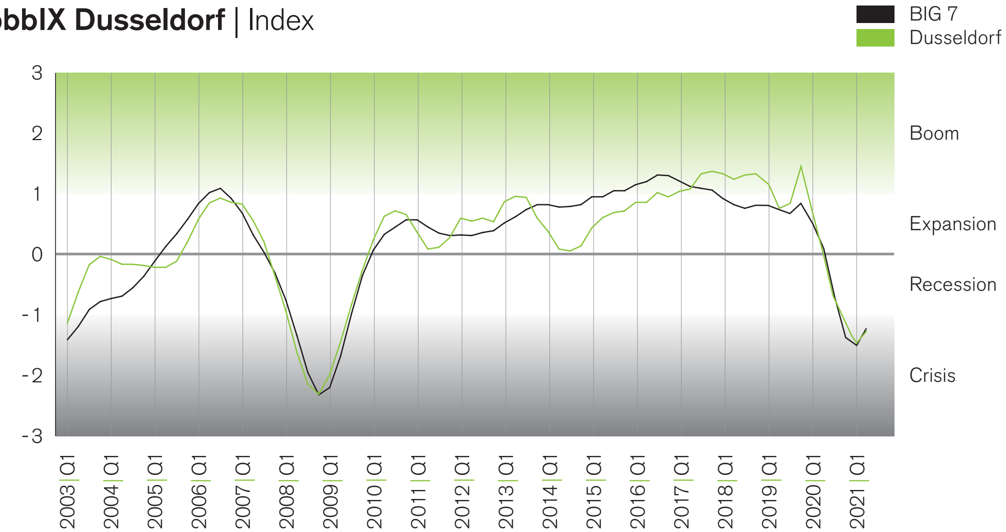
pbbIX Frankfurt | Index



DUSSELDORF

The letting performance has been on a low level for a year now, with hardly any quarterly fluctuations. Most recently, a lack of larger transactions played a role, increasing the current vacancy rate to 7.6%. However, nominal top and average rents for newly-let space remained stable. Dusseldorf's investment market also lacked dynamic development. Nevertheless, inflows did increase compared to the very weak first quarter. According to Real Capital Analytics, around €570 million was invested during the first half of the year, i.e. 63% less than in the first six months of 2020. Once again, this was down to a lack of larger transactions. Notwithstanding this, net initial yields for first-class properties went down in the second quarter, to a range of between 2.8% and 2.9% at the end of the first half-year

pbbIX Dusseldorf | Index

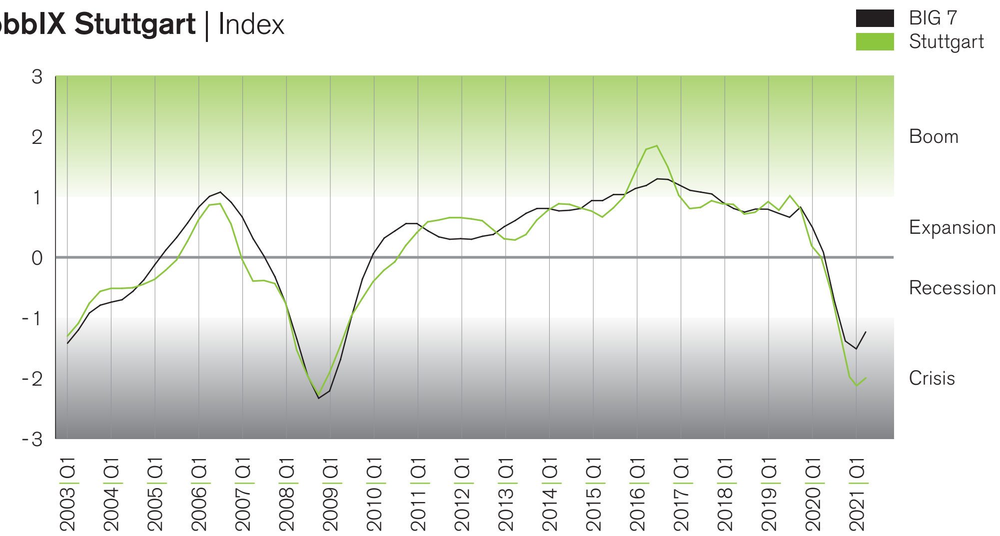


BIG 7

STUTTGART

Turnover on Stuttgart's office market slumped again in the second quarter of 2021, to 17,000 sqm, following 33,000 sqm in the first quarter. Therefore, letting performance in the first half-year was 37% lower than 2020's already below-average first half-year. However, due to low new construction activity in the second quarter, the vacancy rate did not increase but remained very low at between 1.8% and 2%. Nominal rents for newly-let space also remained stable. Traditionally, domestic investors dominate the investment market in Stuttgart, and – as in the previous quarters – they once again held back in the second quarter. All in all, the purchase volume for office properties only amounted to approximately €100 million. Net initial yields for first-class properties remained unchanged compared to the previous quarter.

pbbIX Stuttgart | Index



About the pbbIX real estate index

SCOPE AND METHODOLOGY

As the last two decades have shown very clearly, the development of real estate markets is not a continuous trend that is free of disruption – instead, they are characterised by significant cyclical fluctuations. The pbbIX index family tracks these fluctuations on Germany's key office property markets. The index family comprises a total of eight indices: seven individual indices for the office property markets in Berlin, Cologne, Dusseldorf, Frankfurt, Hamburg, Munich and Stuttgart, plus a composite index which tracks overall economic development of the ‚BIG 7' markets.

The indices are based on the results of a dynamic factor model, which brings together eleven variables, using time series to extract the key driving forces for economic trends of office property markets. Specifically, these variables relate to macroeconomic developments, the rental market, and the investment market across the seven office property markets covered. As a preparatory step for the factor analysis, the various market-related indicators are aggregated to form a market indicator measuring a development overall (for example, vacancies or new construction activity). The data list shown below sets out the indicators which were used for the dynamic factor analysis.

In addition to the office property market indices, the presentation contains assessments regarding the components of ‚macroeconomic developments', ‚market for office space', and ‚market for office investments'. The directional impact of these components on the composite indicator is colour-coded: GREEN indicates a positive, BLACK a negative and GREY a neutral impact.

DATA LIST OF THE DYNAMIC FACTOR MODEL

Macro-economic developments

- Real gross domestic product, (YOY change, in %)
- Workforce in the BIG 7 markets (YOY change, in %)
- Consumer prices, (YOY change, in %)
- Current yield (Umlaufrendite) for public-sector bonds with a minimum remaining term of 10 years (in %)

Rental market

- Completed office and administrative buildings (m^2 of floor space in the BIG 7 markets)
- Marketing volume (m^2 of floor space, in the BIG 7 markets)
- Vacancies (% of gross available area, in the BIG 7 markets)
- Top rent (€ per m^2, for the BIG 7 markets
- Average rent (€ per m^2, for the BIG 7markets.

Investment market

- Net initial yield (in %, for the BIG 7 markets)
- Inflow of funds (€ millions)